

AMENDED IN SENATE JUNE 4, 2007

CALIFORNIA LEGISLATURE—2007–08 REGULAR SESSION

**ASSEMBLY BILL**

**No. 796**

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**Introduced by Committee on Insurance (Coto (Chair), Benoit (Vice Chair), Berg, Carter, De Leon, Duvall, and Parra)**

February 22, 2007

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An act to amend ~~Section 10082.5~~ Sections 739.3, 1765.1, 10082.5, and 12100 of the Insurance Code, relating to ~~earthquake~~ insurance.

LEGISLATIVE COUNSEL'S DIGEST

AB 796, as amended, Committee on Insurance. ~~Earthquake insurance. Insurance.~~

*Existing law requires that insurers file a comprehensive financial plan with the commissioner on the occurrence of a Company Action Level Event, as defined. That report must be filed if, among other things, certain insurers' annual Risk-Based Capital (RBC) report indicates either of 2 specified levels of Total Adjustable Capital.*

*This bill would add another level of Total Adjusted Capital which, with respect to certain insurers, would be indicated in the insurer's RBC report.*

*Existing law limits the ability of a surplus line broker to place any coverage with a nonadmitted insurer, as specified. In order for a nonadmitted insurer to qualify for coverage it must demonstrate financial stability, as defined. In making this showing, securities specifically valued by the National Association of Insurance Commissioners Securities Valuation Office are presumed to be readily marketable, absent evidence to the contrary.*

*This bill would delete the presumption relating to marketability of securities valued by the National Association of Insurance Commissioners.*

*Existing law requires that Insurance Exchanges created and authorized under the laws of individual states maintain specified amounts of capital and surplus. In demonstrating this requirement, securities specifically valued by the National Association of Insurance Commissioner Securities Valuation Office are presumed to be readily marketable, absent evidence to the contrary.*

*This bill would delete the presumption relating to marketability of securities valued by the National Association of Insurance Commissioners.*

Existing law requires an insurer who charges an additional earthquake insurance premium or deductible because a dwelling fails to meet certain criteria to not charge the same if the dwelling is brought into compliance with specified building code provisions.

This bill would include successor editions of the building code provisions for those purposes.

*Existing law defines financial guaranty insurance, and provides that a credit default swap shall not constitute an insurance contract and shall not constitute the transaction of insurance.*

*This bill would recast the definition of a credit default swap.*

Vote: majority. Appropriation: no. Fiscal committee: ~~no~~ yes.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1     *SECTION 1. Section 739.3 of the Insurance Code is amended*  
2     *to read:*  
3     739.3. (a) “Company Action Level Event” means any of the  
4     following events:  
5     (1) The filing of an RBC Report by an insurer that indicates  
6     ~~either~~ any of the following:  
7     (A) The insurer’s Total Adjusted Capital is greater than or equal  
8     to its Regulatory Action Level RBC but less than its Company  
9     Action Level RBC.  
10    (B) If a life or health insurer, the insurer has Total Adjusted  
11    Capital that is greater than or equal to its Company Action Level  
12    RBC but less than the product of its Authorized Control Level  
13    RBC and 2.5, and has a negative trend.

1 (C) *If a property and casualty insurer, the insurer has Total*  
2 *Adjusted Capital which is greater than or equal to its Company*  
3 *Action Level RBC but less than the product of its Authorized*  
4 *Control Level RBC and 3.0, and triggers the trend test determined*  
5 *in accordance with the trend test calculation included in the*  
6 *Property and Casualty RBC instructions.*

7 (2) The notification by the commissioner to the insurer of an  
8 Adjusted RBC Report that indicates the event in subparagraph (A)  
9 or (B) of paragraph (1), provided the insurer does not challenge  
10 the Adjusted RBC Report under Section 739.7.

11 (3) If the insurer challenges an Adjusted RBC Report that  
12 indicates the event in subparagraph (A) or (B) of paragraph (1)  
13 under Section 739.7, the notification by the commissioner to the  
14 insurer that the commissioner has, after a hearing, rejected the  
15 insurer's challenge.

16 (b) In the event of a Company Action Level Event, the insurer  
17 shall prepare and submit to the commissioner a comprehensive  
18 financial plan which shall do all of the following:

19 (1) Identify the conditions in the insurer that contribute to the  
20 Company Action Level Event.

21 (2) Contain proposals of corrective actions that the insurer  
22 intends to take and would be expected to result in the elimination  
23 of the Company Action Level Event.

24 (3) Provide projections of the insurer's financial results in the  
25 current year and at least the four succeeding years, both in the  
26 absence of proposed corrective actions and giving effect to the  
27 proposed corrective actions, including projections of statutory  
28 operating income, net income, capital, or surplus, or a combination.  
29 The projections for both new and renewal business may include  
30 separate projections for each major line of business and separately  
31 identify each significant income, expense, and benefit component.

32 (4) Identify the key assumptions impacting the insurer's  
33 projections and the sensitivity of the projections to the assumptions.

34 (5) Identify the quality of, and problems associated with, the  
35 insurer's business, including, but not limited to, its assets,  
36 anticipated business growth and associated surplus strain,  
37 extraordinary exposure to risk, mix of business, and use of  
38 reinsurance in each case, if any.

39 (c) The RBC Plan shall be submitted as follows:

40 (1) Within 45 days of the Company Action Level Event.

(2) If the insurer challenges an Adjusted RBC Report pursuant to Section 739.7, within 45 days after notification to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge.

(d) Within 60 days after the submission by an insurer of an RBC Plan to the commissioner, the commissioner shall notify the insurer whether the RBC Plan shall be implemented or is, in the judgment of the commissioner, unsatisfactory. If the commissioner determines the RBC Plan is unsatisfactory, the notification to the insurer shall set forth the reasons for the determination, and may set forth proposed revisions that will render the RBC Plan satisfactory, in the judgment of the commissioner. Upon notification from the commissioner, the insurer shall prepare a Revised RBC Plan, which may incorporate by reference any revisions proposed by the commissioner, and shall submit the Revised RBC Plan to the commissioner as follows:

(1) Within 45 days after the notification from the commissioner.

(2) If the insurer challenges the notification from the commissioner under Section 739.7, within 45 days after a notification to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge.

(e) In the event of a notification by the commissioner to an insurer that the insurer's RBC Plan or Revised RBC Plan is unsatisfactory, the commissioner may at the commissioner's discretion, subject to the insurer's right to a hearing under Section 739.7, specify in the notification that the notification constitutes a Regulatory Action Level Event.

(f) Every domestic insurer that files an RBC Plan or Revised RBC Plan with the commissioner shall file a copy of the RBC Plan or Revised RBC Plan with the insurance commissioner in any state in which the insurer is authorized to do business if the following apply:

(1) That state has an RBC provision substantially similar to subdivision (a) of Section 739.8.

(2) The insurance commissioner of that state has notified the insurer of its request for the filing in writing, in which case the insurer shall file a copy of the RBC Plan or Revised RBC Plan in that state no later than the later of:

(A) Fifteen days after the receipt of notice to file a copy of its RBC Plan or Revised RBC Plan with the state.

1 (B) The date on which the RBC Plan or Revised RBC Plan is  
2 filed under subdivision (c) of Section 739.7.

3 *SEC. 2. Section 1765.1 of the Insurance Code is amended to*  
4 *read:*

5 1765.1. No surplus line broker shall place any coverage with  
6 a nonadmitted insurer unless the insurer is domiciled in the  
7 Republic of Mexico and the placement covers only liability arising  
8 out of the ownership, maintenance, or use of a motor vehicle,  
9 aircraft, or boat in the Republic of Mexico, or, at the time of  
10 placement, the nonadmitted insurer meets the following  
11 requirements:

12 (a) (1) Has established its financial stability, reputation, and  
13 integrity, for the class of insurance the broker proposes to place,  
14 by satisfactory evidence submitted to the commissioner through  
15 a surplus line broker.

16 (2) Meets one of the following requirements with respect to its  
17 financial stability:

18 (A) Has capital and surplus that together total at least fifteen  
19 million dollars (\$15,000,000). "Capital" shall be as defined in  
20 Section 36. "Surplus" shall be defined as assets exceeding the sum  
21 of liabilities for losses reported, expenses, taxes, and all other  
22 indebtedness and reinsurance of outstanding risks as provided by  
23 law and paid-in capital in the case of an insurer issuing or having  
24 outstanding shares of capital stock. The type of assets to be used  
25 in calculating capital and surplus shall be as follows: at least fifteen  
26 million dollars (\$15,000,000) shall be in the form of cash, or  
27 securities of the same character and quality as specified in Sections  
28 1170 to 1182, inclusive, or in readily marketable securities listed  
29 on regulated United States' national or principal regional securities  
30 exchanges. The remaining assets shall be in the form just described,  
31 or in the form of investments of substantially the same character  
32 and quality as described in Sections 1190 to 1202, inclusive. In  
33 calculating capital and surplus under this section, the term "same  
34 character and quality" shall permit, but not require, the  
35 commissioner to approve assets maintained in accordance with  
36 the laws of another state or country. The commissioner shall be  
37 guided by any limitations, restrictions, or other requirements of  
38 this code or the National Association of Insurance Commissioners'  
39 Accounting Practices and Procedures Manual in determining  
40 whether assets substantially similar to those described in Sections

1 1190 to 1202, inclusive, qualify. The commissioner shall retain  
2 the discretion to disapprove or disallow any asset that is not of a  
3 sound quality, or that he or she deems to create an unacceptable  
4 risk of loss to the insurer or to policyholders. ~~Securities specifically~~  
5 ~~valued by the National Association of Insurance Commissioners~~  
6 ~~Securities Valuation Office shall be presumed readily marketable~~  
7 ~~absent evidence to the contrary.~~ Letters of credit will not qualify  
8 as assets in the calculation of surplus. If less than fifteen million  
9 dollars (\$15,000,000), the commissioner has affirmatively found  
10 that the capital and surplus is adequate to protect California  
11 policyholders. The commissioner shall consider, on determining  
12 whether to make this finding, factors such as quality of  
13 management, the capital and surplus of any parent company, the  
14 underwriting profit and investment income trends, and the record  
15 of claims payment and claims handling practices of the  
16 nonadmitted insurer.

17 (B) In the case of an “Insurance Exchange” created and  
18 authorized under the laws of individual states, maintains capital  
19 and surplus of not less than fifty million dollars (\$50,000,000) in  
20 the aggregate. “Capital” shall be as defined in Section 36. “Surplus”  
21 shall be defined as assets exceeding the sum of liabilities for losses  
22 reported, expenses, taxes, and all other indebtedness and  
23 reinsurance of outstanding risks as provided by law and paid-in  
24 capital in the case of an insurer issuing or having outstanding shares  
25 of capital stock. The type of assets to be used in calculating capital  
26 and surplus shall be as follows: at least fifteen million dollars  
27 (\$15,000,000) shall be in the form of cash, or securities of the same  
28 character and quality as specified in Sections 1170 to 1182,  
29 inclusive, or in readily marketable securities listed on regulated  
30 United States’ national or principal regional securities exchanges.  
31 The remaining assets shall be in the form just described, or in the  
32 form of investments of substantially the same character and quality  
33 as described in Sections 1190 to 1202, inclusive. In calculating  
34 capital and surplus under this section, the term “same character  
35 and quality” shall permit, but not require, the commissioner to  
36 approve assets maintained in accordance with the laws of another  
37 state or country. The commissioner shall be guided by any  
38 limitations, restrictions, or other requirements of this code or the  
39 National Association of Insurance Commissioners’ Accounting  
40 Practices and Procedures Manual in determining whether assets

1 substantially similar to those described in Sections 1190 to 1202,  
 2 inclusive, qualify. The commissioner shall retain the discretion to  
 3 disapprove or disallow any asset that is not of a sound quality, or  
 4 that he or she deems to create an unacceptable risk of loss to the  
 5 insurer or to policyholders. ~~Securities specifically valued by the~~  
 6 ~~National Association of Insurance Commissioners Securities~~  
 7 ~~Valuation Office shall be presumed readily marketable absent~~  
 8 ~~evidence to the contrary.~~ Letters of credit shall not qualify as assets  
 9 in the calculation of surplus. In the case of an Insurance Exchange  
 10 which maintains funds for the protection of all Insurance Exchange  
 11 policyholders, each individual syndicate seeking to accept surplus  
 12 line placements of risks resident, located, or to be performed in  
 13 this state shall maintain minimum capital and surplus of not less  
 14 than six million four hundred thousand dollars (\$6,400,000). Each  
 15 individual syndicate shall increase the capital and surplus required  
 16 by this paragraph by one million dollars (\$1,000,000) each year  
 17 until it attains a capital and surplus of fifteen million dollars  
 18 (\$15,000,000). In the case of Insurance Exchanges that do not  
 19 maintain funds for the protection of all Insurance Exchange  
 20 policyholders, each individual syndicate seeking to accept surplus  
 21 line placement of risks resident, located, or to be performed in this  
 22 state shall meet the capital and surplus requirements of  
 23 subparagraph (A) of this paragraph.

24 (C) In the case of a syndicate that is part of a group consisting  
 25 of incorporated individual insurers, or a combination of both  
 26 incorporated and unincorporated insurers, that at all times maintains  
 27 a trust fund of not less than one hundred million dollars  
 28 (\$100,000,000) in a qualified United States financial institution  
 29 as security to the full amount thereof for the United States surplus  
 30 line policyholders and beneficiaries of direct policies of the group,  
 31 including all policyholders and beneficiaries of direct policies of  
 32 the syndicate, and the full balance in the trust fund is available to  
 33 satisfy the liabilities of each member of the group of those  
 34 syndicates, incorporated individual insurers or other unincorporated  
 35 insurers, without regard to their individual contributions to that  
 36 trust fund, and the trust complies with the terms of and conditions  
 37 specified in paragraph (1) of subdivision (b), the syndicate is  
 38 excepted from the capital and surplus requirements of subparagraph  
 39 (A) of paragraph (2). The incorporated members of the group shall  
 40 not be engaged in any business other than underwriting as a

1 member of the group and shall be subject to the same level of  
2 solvency regulation and control by the group's domiciliary  
3 regulator as are the unincorporated members.

4 (b) (1) In addition, to be eligible as a surplus line insurer, an  
5 insurer not domiciled in one of the United States or its territories  
6 shall have in force in the United States an irrevocable trust account  
7 in a qualified United States financial institution, for the protection  
8 of United States policyholders, of not less than five million four  
9 hundred thousand dollars (\$5,400,000) and consisting of cash,  
10 securities acceptable to the commissioner which are authorized  
11 pursuant to Sections 1170 to 1182, inclusive, readily marketable  
12 securities acceptable to the commissioner that are listed on a  
13 regulated United States national or principal regional security  
14 exchange, or clean and irrevocable letters of credit acceptable to  
15 the commissioner and issued by a qualified United States financial  
16 institution. The trust agreement shall be in a form acceptable to  
17 the commissioner. The funds in the trust account may be included  
18 in any calculation of capital and surplus, except letters of credit,  
19 which shall not be included in any calculation.

20 (2) In the case of a syndicate seeking eligibility under  
21 subparagraph (C) of paragraph (2) of subdivision (a), the syndicate  
22 shall, in addition to the requirements of that subparagraph, at a  
23 minimum, maintain in the United States a trust account in an  
24 amount satisfactory to the commissioner that is not less than the  
25 amount required by the domiciliary state of the syndicate's trust.  
26 The trust account shall comply with the terms and conditions  
27 specified in paragraph (1).

28 (3) In the case of a group of incorporated insurers under common  
29 administration that maintains a trust fund of not less than one  
30 hundred million dollars (\$100,000,000) in a qualified United States  
31 financial institution for the payment of claims of its United States  
32 policyholders, their assigns, or successors in interest and that  
33 complies with the terms and conditions of paragraph (1) that has  
34 continuously transacted an insurance business outside the United  
35 States for at least three years, that is in good standing with its  
36 domiciliary regulator, whose individual insurer members maintain  
37 standards and a financial condition reasonably comparable to  
38 admitted insurers, that submits to this state's authority to examine  
39 its books and bears the expense of examination, and that has an  
40 aggregate policyholder surplus of ten billion dollars



1 (\$10,000,000,000), the group is excepted from the capital and  
2 surplus requirements of subdivision (a).

3 (c) Has caused to be provided to the commissioner the following  
4 documents:

5 (1) The financial documents as specified below, each showing  
6 the insurer's condition as of a date not more than 12 months prior  
7 to submission:

8 (A) A copy of an annual statement, prepared in the form  
9 prescribed by the NAIC. For an alien insurer, in lieu of an annual  
10 statement, a licensee may submit a form as set forth by regulation  
11 and as prepared by the insurer, and, if listed by the IID, a copy of  
12 the complete information as required in the application for listing  
13 by the IID.

14 (B) A copy of an audited financial report on the insurer's  
15 condition that meets the standards of subparagraph (D) for foreign  
16 insurers or subparagraph (E) for alien insurers.

17 (C) If the insurer is an alien:

18 (i) A certified copy of the trust agreement referenced in  
19 subdivision (b).

20 (ii) A verified copy of the most recent quarterly statement or  
21 list of the assets in the trust.

22 (D) Financial reports filed pursuant to this section by foreign  
23 insurers shall conform to the following standards:

24 (i) Financial documents shall be certified.

25 (ii) An audited financial report shall constitute a supplement to  
26 the insurer's annual statement, as required by the annual statement  
27 instructions issued by the NAIC.

28 (iii) An audited financial report shall be prepared by an  
29 independent certified public accountant or accounting firm in good  
30 standing with the American Institute of Certified Public  
31 Accountants and in all states where licensed to practice; and be  
32 prepared in conformity with statutory accounting practices  
33 prescribed, or otherwise permitted, by the insurance regulator of  
34 the insurer's domiciliary jurisdiction.

35 (iv) An audited financial report shall include information on the  
36 insurer's financial position as of the end of the most recent calendar  
37 year, and the results of its operations, cash-flows, and changes in  
38 capital and surplus for the year then ended.

39 (v) An audited financial report shall be prepared in a form and  
40 using language and groupings substantially the same as the relevant

1 sections of the insurer's annual statement filed with its domiciliary  
2 jurisdiction, and presenting comparatively the amounts as of  
3 December 31 of the most recent calendar year and the amounts as  
4 of December 31 of the preceding year.

5 (E) Financial reports filed pursuant to this section by alien  
6 insurers shall conform to the following standards:

7 (i) Except as provided in clause (ii) of subparagraph (C),  
8 financial documents should be certified, if certification of a  
9 financial document is not available, the document shall be verified.

10 (ii) Financial documents should be expressed in United States  
11 dollars, but may be expressed in another currency, if the exchange  
12 rate for the other currency as of the date of the document is also  
13 provided.

14 (iii) The responses provided pursuant to subparagraph (A) of  
15 paragraph (1) on the form submitted in lieu of an annual statement  
16 should follow the most recent ISI Guide to Alien Reporting Format,  
17 "Standard Definitions of Accounting Items." Responses that do  
18 not agree with a standard definition shall be fully explained in the  
19 form.

20 (iv) An audited financial report shall be prepared by an  
21 independent licensed auditor in the insurer's domiciliary  
22 jurisdiction or in any state.

23 (v) An audited financial report shall be prepared in accord with  
24 either (I) Generally Accepted Auditing Standards that prescribe  
25 Generally Accepted Accounting Principles, or (II) International  
26 Accounting Standards as published and revised from time to time  
27 by the International Auditing Guidelines published by the  
28 International Auditing Practice Committee of the International  
29 Federation of Accountants; and shall include financial statement  
30 notes and a summary of significant accounting practices.

31 (F) The commissioner may accept, in lieu of a document  
32 described above, any certified or verified financial or regulatory  
33 document, statement, or report if the commissioner finds that it  
34 possesses reliability and financial detail substantially equal to or  
35 greater than the document for which it is proposed to be a  
36 substitute.

37 (G) If one of the financial documents required to be submitted  
38 under subparagraphs (A) and (B) is dated within 12 months of  
39 submission, but the other document is not so dated, the licensee  
40 may use the outdated document if it is accompanied by a

1 supplement. The supplement must meet the same requirements  
2 which apply to the supplemented document, and must update the  
3 outdated document to a date within the prescribed time period,  
4 preferably to the same date as the nonsupplemented document.

5 (2) A certified copy of the insurer's license issued by its  
6 domiciliary jurisdiction, plus a certification of good standing,  
7 certificate of compliance, or other equivalent certificate, from  
8 either that jurisdiction or, if the jurisdiction does not issue those  
9 certificates, from any state where it is licensed.

10 (3) Information on the insurer's agent in California for service  
11 of process, including the agent's full name and address. The agent's  
12 address must include a street address where the agent can be  
13 reached during normal business hours.

14 (4) The complete street address, mailing address, and telephone  
15 number of the insurer's principal place of business.

16 (5) A certified or verified explanation, report, or other statement,  
17 from the insurance regulatory office or official of the insurer's  
18 domiciliary jurisdiction, concerning the insurer's record regarding  
19 market conduct and consumer complaints; or, if that information  
20 cannot be obtained from that jurisdiction, then any other  
21 information that the licensee can procure to demonstrate a good  
22 reputation for payment of claims and treatment of policyholders.

23 (6) A verified statement, from the insurer or licensee, on whether  
24 the insurer or any affiliated entity is currently known to be the  
25 subject of any order or proceeding regarding conservation,  
26 liquidation, or other receivership; or regarding revocation or  
27 suspension of a license to transact insurance in any jurisdiction;  
28 or otherwise seeking to stop the insurer from transacting insurance  
29 in any jurisdiction. The statement shall identify the proceeding by  
30 date, jurisdiction, and relief or sanction sought; and shall attach a  
31 copy of the relevant order.

32 (7) A certified copy of the most recent report of examination  
33 or an explanation if the report is not available.

34 (8) A list of all California surplus line brokers authorized by  
35 the insurer to issue policies on its behalf, and any additions to or  
36 deletions from that list.

37 (d) (1) Has provided any additional information or  
38 documentation required by the commissioner that is relevant to  
39 the financial stability, reputation, and integrity of the nonadmitted  
40 insurer. In making a determination concerning financial stability,

1 reputation, and integrity of the nonadmitted insurer, the  
2 commissioner shall consider any analyses, findings, or conclusions  
3 made by the National Association of Insurance Commissioners  
4 (NAIC) in its review of the insurer for purposes of inclusion on  
5 or exclusion from the list of authorized nonadmitted insurers  
6 maintained by the NAIC. The commissioner may, but shall not be  
7 required to, rely on, adopt, or otherwise accept any analyses,  
8 findings, or conclusions of the NAIC, as the commissioner deems  
9 appropriate. In the case of a syndicate seeking eligibility under  
10 subparagraph (C) of paragraph (2) of subdivision (a), the  
11 commissioner may, but shall not be required to, rely on, adopt, or  
12 otherwise accept any analyses, findings, or conclusions of any  
13 state, as the commissioner deems appropriate, as long as that state,  
14 in its method of regulation and review, meets the requirements of  
15 paragraph (2).

16 (2) The regulatory body of the state shall regularly receive and  
17 review the following: (A) an audited financial statement of the  
18 syndicate, prepared by a certified or chartered public accountant;  
19 (B) an opinion of a qualified actuary with regard to the syndicate's  
20 aggregate reserves for payment of losses or claims and payment  
21 of expenses of adjustment or settlement of losses or claims; (C) a  
22 certification from the qualified United States financial institution  
23 that acts as the syndicate's trustee, respecting the existence and  
24 value of the syndicate's trust fund; and (D) information concerning  
25 the syndicate's or its manager's operating history, business plan,  
26 ownership and control, experience and ability, together with any  
27 other pertinent factors, and any information indicating that the  
28 syndicate or its manager make reasonably prompt payment of  
29 claims in this state or elsewhere. The regulatory body of the state  
30 shall have the authority, either by law or through the operation of  
31 a valid and enforceable agreement, to review the syndicate's assets  
32 and liabilities and audit the syndicate's trust account, and shall  
33 exercise that authority with a frequency and in a manner  
34 satisfactory to the commissioner.

35 (e) Has established that:

36 (1) All documents required by subdivisions (c) and (d) have  
37 been filed. Each of the documents appear after review to be  
38 complete, clear, comprehensible, unambiguous, accurate, and  
39 consistent.

1 (2) The documents affirm that the insurer is not subject in any  
2 jurisdiction to an order or proceeding that:

3 (A) Seeks to stop it from transacting insurance.

4 (B) Relates to conservation, liquidation, or other receivership.

5 (C) Relates to revocation or suspension of its license.

6 (3) The documents affirm that the insurer has actively transacted  
7 insurance for the three years immediately preceding the filing made  
8 under this section, unless an exemption is granted. As used in this  
9 paragraph, “insurer” does not include a syndicate of underwriting  
10 entities. The commissioner may grant an exemption if the licensee  
11 has applied for exemption and demonstrates either of the following:

12 (A) The insurer meets the condition for any exception set forth  
13 in subdivision (a), (b), or (c) of Section 716.

14 (B) If the insurer has been actively transacting insurance for at  
15 least 12 months, and the licensee demonstrates that the exemption  
16 is warranted because the insurer’s current financial strength,  
17 operating history, business plan, ownership and control,  
18 management experience, and ability, together with any other  
19 pertinent factors, make three years of active insurance transaction  
20 unnecessary to establish sufficient reputation.

21 (4) The documents confirm that the insurer holds a license to  
22 issue insurance policies (other than reinsurance) to residents of  
23 the jurisdiction that granted the license unless an exemption is  
24 granted. The commissioner may grant an exemption if the licensee  
25 has applied for an exemption and demonstrates that the exemption  
26 is warranted because the insurer proposes to issue in California  
27 only commercial coverage, and is wholly owned and actually  
28 controlled by substantial and knowledgeable business enterprises  
29 that are its policyholders and that effectively govern the insurer’s  
30 destiny in furtherance of their own business objectives.

31 (5) The information filed pursuant to paragraph (5) of  
32 subdivision (c) or otherwise filed with or available to the  
33 commissioner, including reports received from California  
34 policyholders, shall indicate that the insurer makes reasonably  
35 prompt payment of claims in this state or elsewhere.

36 (6) The information available to the commissioner shall not  
37 indicate that the insurer offers in California a licensee products or  
38 rates that violate any provision of this code.

39 (f) Has been placed on the list of eligible surplus line insurers  
40 by the commissioner. The commissioner shall establish a list of

1 all surplus line insurers that have met the requirements of  
2 subdivisions (a) to (e), inclusive, and shall publish a master list at  
3 least semiannually. Any insurer receiving approval as an eligible  
4 surplus line insurer shall be added by addendum to the list at the  
5 time of approval, and shall be incorporated into the master list at  
6 the next date of publication. If an insurer appears on the most  
7 recent list, it shall be presumed that the insurer is an eligible surplus  
8 line insurer, unless the commissioner or his or her designee has  
9 mailed or causes to be mailed notice to all surplus line brokers that  
10 the commissioner has withdrawn the insurer's eligibility. Upon  
11 receipt of notice, the surplus line broker shall make no further  
12 placements with the insurer. Nothing in this subdivision shall limit  
13 the commissioner's discretion to withdraw an insurer's eligibility.

14 (g) (1) Except as provided by paragraph (2), whenever the  
15 commissioner has reasonable cause to believe, and determines  
16 after a public hearing, that any insurer on the list established  
17 pursuant to subdivision (f), (A) is in an unsound financial condition,  
18 (B) does not meet the eligibility requirements under subdivisions  
19 (a) to (e), inclusive, (C) has violated the laws of this state, or (D)  
20 without justification, or with a frequency so as to indicate a general  
21 business practice, delays the payment of just claims, the  
22 commissioner may issue an order removing the insurer from the  
23 list. Notice of hearing shall be served upon the insurer or its agent  
24 for service of process stating the time and place of the hearing and  
25 the conduct, condition, or ground upon which the commissioner  
26 would make his or her order. The hearing shall occur not less than  
27 20 days, nor more than 30 days after notice is served upon the  
28 insurer or its agent for service of process.

29 (2) If the commissioner determines that an insurer's immediate  
30 removal from the list is necessary to protect the public or an insured  
31 or prospective insured of the insurer, or, in the case of an  
32 application by an insurer to be placed on the list which is being  
33 denied by the commissioner, the commissioner may issue an order  
34 pursuant to paragraph (1) without prior notice and hearing. At the  
35 time an order is served pursuant to this paragraph to an insurer on  
36 the list, the commissioner shall also issue and serve upon the  
37 insurer a statement of the reasons that immediate removal is  
38 necessary. Any order issued pursuant to this paragraph shall include  
39 a notice stating the time and place of a hearing on the order, which

1 shall be not less than 20 days, nor more than 30 days after the  
2 notice is served.

3 (3) Notwithstanding paragraphs (1) and (2), in any case where  
4 the commissioner is basing a decision to remove an insurer from  
5 the list, or deny an application to be placed on the list, on the failure  
6 of the insurer or applicant to comply with, meet or maintain any  
7 of the objective criteria established by this section, or by regulation  
8 adopted pursuant to this section, the commissioner may so specify  
9 this fact in the order, and no hearing shall be required to be held  
10 on the order.

11 (4) Notwithstanding paragraphs (1) and (2), the commissioner  
12 may, without prior notice or hearing, remove from the list  
13 established pursuant to subdivision (f) any insurer that has failed  
14 or refused to timely provide documents required by this section,  
15 or any regulations adopted to implement this section. In the case  
16 of removal pursuant to this paragraph, the commissioner shall  
17 notify all surplus line brokers of the action.

18 (h) In addition to any other statements or reports required by  
19 this chapter, the commissioner may also address to any licensee a  
20 written request for full and complete information respecting the  
21 financial stability, reputation and integrity of any nonadmitted  
22 insurer with whom the licensee has dealt or proposes to deal in the  
23 transaction of insurance business. The licensee so addressed shall  
24 promptly furnish in written or printed form so much of the  
25 information requested as he or she can produce together with a  
26 signed statement identifying the same and giving reasons for  
27 omissions, if any. After due examination of the information and  
28 accompanying statement, the commissioner may, if he or she  
29 believes it to be in the public interest, order the licensee in writing  
30 to place no further insurance business on property located or  
31 operations conducted within or on the lives of persons who are  
32 residents of this state with the nonadmitted insurer on behalf of  
33 any person. Any placement in the nonadmitted insurer made by a  
34 licensee after receipt of that order is a violation of this chapter.  
35 The commissioner may issue an order when documents submitted  
36 pursuant to subdivisions (c) and (d) do not meet the criteria of  
37 subdivisions (a) to (e), inclusive, or when the commissioner obtains  
38 documents on an insurer and the insurer does not meet the criteria  
39 of subdivisions (a) to (e), inclusive.

1 (i) The commissioner shall require, at least annually, the  
2 submission of records and statements as are reasonably necessary  
3 to ensure that the requirements of this section are maintained.

4 (j) The commissioner shall establish by regulation a schedule  
5 of fees to cover costs of administering and enforcing this chapter.

6 (k) (1) Insurance may be placed on a limited basis with insurers  
7 not on the list established pursuant to this section if all of the  
8 following conditions are met:

9 (A) The use of multiple insurers is necessary to obtain coverage  
10 for 100 percent of the risk.

11 (B) At least 80 percent of the risk is placed with admitted  
12 insurers or insurers that appear on the list of eligible nonadmitted  
13 insurers.

14 (C) The placing surplus line broker submits to the commissioner,  
15 or his or her designee, copies of all documentation relied upon by  
16 the surplus line broker to make the broker's determination that the  
17 financial stability, reputation, and integrity of the unlisted insurer  
18 or insurers, are adequate to safeguard the interest of the insured  
19 under the policy. This documentation, and any other documentation  
20 regarding the unlisted insurer requested by the commissioner, shall  
21 be submitted no more than 30 days after the insurance is placed  
22 with the unlisted insurer for the initial placement by that broker  
23 with the particular unlisted insurer, and annually thereafter for as  
24 long as the broker continues to make placements with the unlisted  
25 insurer pursuant to this paragraph.

26 (D) The insured has aggregate annual premiums for all risks  
27 other than workers' compensation or health coverage totaling no  
28 less than one hundred thousand dollars (\$100,000).

29 (2) Insurance may not be placed pursuant to paragraph (1) if  
30 any of the following applies:

31 (A) The unlisted insurer has for any reason been objected to by  
32 the commissioner pursuant to this section, removed from the list,  
33 or denied placement on the list.

34 (B) The insurance includes coverage for employer-sponsored  
35 medical, surgical, hospital, or other health or medical expense  
36 benefits payable to the employee by the insurer.

37 (C) The insurance is mandatory under the laws of the federal  
38 government, this state, or any political subdivision thereof, and  
39 includes any portion of limits of coverage mandated by those laws.



1 (D) The insured is a multiple employer welfare arrangement,  
2 as defined in Section 1002(40)(A) of Title 29 of the United States  
3 Code, or any other arrangement among two or more employers  
4 that are not under common ownership or control, which is  
5 established or maintained for the primary purpose of providing  
6 insurance benefits to the employees of two or more employers.

7 (E) Unlisted insurers represent a disproportionate portion of the  
8 lower layers of the coverage.

9 (3) Nothing in this section is intended to alter any duties of a  
10 surplus line broker pursuant to subdivision (b) of Section 1765 or  
11 other laws of this state to safeguard the interests of the insured  
12 under the policy in recommending or placing insurance with a  
13 nonadmitted insurer.

14 (4) Placements authorized by this subdivision are intended to  
15 provide sophisticated insurance purchasers with a means to obtain  
16 necessary commercial insurance coverage from nonadmitted  
17 insurers not listed by the commissioner in situations where it is  
18 not commercially possible to fully obtain that coverage from either  
19 admitted or listed insurers. This subdivision shall not be deemed  
20 to permit surplus line brokers to place with nonadmitted insurers  
21 common commercial or personal line coverages for insureds that  
22 can be placed with insurers that are admitted or listed pursuant to  
23 this section, whether the insured is an individual insured, or a group  
24 created primarily for the purpose of purchasing insurance.

25 (I) As used in this section:

26 (1) "Certified" means an originally signed or sealed statement,  
27 dated not more than 60 days before submission, made by a public  
28 official or other person, attached to a copy of a document, that  
29 attests that the copy is a true copy of the original, and that the  
30 original is in the custody of the person making the statement.

31 (2) "Domiciliary jurisdiction" means the state, nation, or  
32 subdivision thereof under the laws of which an insurer is  
33 incorporated or otherwise organized.

34 (3) "Domiciliary state of the syndicate's trust" means the state  
35 in which the syndicate's trust fund is principally maintained and  
36 administered for the benefit of the syndicate's policyholders in the  
37 United States.

38 (4) "IID" means the International Insurers Department.

39 (5) "Insurer" means (unless the context indicates otherwise)  
40 "nonadmitted" insurers that are either "foreign" or "alien" insurers,

1 as those terms are defined in Sections 25, 27, and 1580, and  
2 syndicates whose members consist of individual incorporated  
3 insurers who are not engaged in any business other than  
4 underwriting as a member of the group and individual  
5 unincorporated insurers, provided all the members are subject to  
6 the same level of solvency regulation and control by the group's  
7 domiciliary regulator. The term "insurer" includes all nonadmitted  
8 insurers selling insurance to or through purchasing groups as  
9 defined in the Liability Risk Retention Act of 1986 (15 U.S.C.  
10 Sec. 3901 et seq.) and the California Risk Retention Act of 1990  
11 (Chapter 1.5 (commencing with Section 125) of Part 1 of Division  
12 1), except insurers that are risk retention groups as defined by those  
13 acts.

14 (6) "ISI" means Insurance Solvency International.

15 (7) "Licensee" means a surplus line broker as defined in Section  
16 47.

17 (8) "NAIC" means the National Association of Insurance  
18 Commissioners or its successor organization.

19 (9) "NAIIO" means the Nonadmitted Alien Insurer Information  
20 Office of the NAIC or its successor office.

21 (10) "State" means any state of the United States; the District  
22 of Columbia; a commonwealth, or a territory.

23 (11) "Verified" means a document or copy accompanied by an  
24 originally signed statement, dated not more than 60 days before  
25 submission, from a responsible executive or official who has  
26 authority to provide the statement and knowledge whereof he or  
27 she speaks, attesting either under oath before a notary public, or  
28 under penalty of perjury under California law, that the assertions  
29 made in the document are true.

30 (m) With respect to a nonadmitted insurer that is listed as an  
31 authorized surplus line insurer as of December 31, 1994, pursuant  
32 to Sections 2174.1 to 2174.14, inclusive, of Title 10 of the  
33 California Code of Regulations, this section shall not be effective  
34 until the subsequent expiration of the listing of that insurer. Nothing  
35 in the bill that amended this section during the 1994 portion of the  
36 1993–94 Regular Session is intended to repeal or imply there is  
37 not authority to adopt, or to have adopted, or to continue in force,  
38 any regulation, or part thereof, with respect to surplus line  
39 insurance which is not clearly inconsistent with it.

1     ~~SECTION 1.~~

2     *SEC. 3.* Section 10082.5 of the Insurance Code is amended to  
3 read:

4     10082.5. If an insurer subject to this chapter charges an  
5 additional earthquake insurance premium or deductible because a  
6 dwelling fails to comply with subdivision (a), (b), or (c) and the  
7 dwelling is subsequently brought into compliance with any one of  
8 these subdivisions, then the additional premium or deductible  
9 attributed to noncompliance shall not be charged.

10    (a) Compliance with the foundation anchor bolt requirements  
11 of subdivision (f) of Section 2907 of Chapter 29 of the 1991 edition  
12 of the Uniform Building Code of the International Conference of  
13 Building Officials, or a successor edition of that code, or with any  
14 local government modifications to those requirements.

15    (b) Compliance with the bracing requirements for cripple walls  
16 of paragraph (4) of subdivision (g) of Section 2517 of Chapter 25  
17 of the 1991 edition of the Uniform Building Code of the  
18 International Conference of Building Officials, or a successor  
19 edition of that code, and with any local government modifications  
20 to those requirements.

21    (c) Compliance with Section 19215 of the Health and Safety  
22 Code for the bracing, anchoring, or strapping all water heaters to  
23 resist falling or horizontal displacement due to earthquake motion.

24    A copy of the approved inspection record for the building permit  
25 for work performed pursuant to this section shall be submitted by  
26 the insured to the insurer in order to verify that retrofits performed  
27 pursuant to this section have been performed.

28     *SEC. 4.* *Section 12100 of the Insurance Code is amended to*  
29 *read:*

30     12100. As used in this article:

31     (a) (1) “Financial guaranty insurance” means a surety bond, an  
32 insurance policy or, when issued by an insurer, an indemnity  
33 contract and any ~~guaranty~~ *guarantee* similar to the foregoing types,  
34 under which loss is payable upon proof of occurrence of financial  
35 loss to an insured claimant, obligee, or indemnitee as a result of  
36 any of the following events:

37       (A) Failure of any obligor on or issuer of any debt instrument  
38 or other monetary obligation (including equity securities ~~guaranteed~~  
39 *guaranteed* under a surety bond, insurance policy, or indemnity  
40 contract) to pay, when due to be paid by the obligor or scheduled

1 at the time insured to be received by the holder of the obligation,  
2 principal, interest, premium, dividend, purchase price of or on the  
3 instrument or obligation, or other monetary payment when the  
4 failure is the result of financial default or insolvency, or, provided  
5 that the payment source is investment grade, any other failure of  
6 that payment source to make payment, regardless of whether the  
7 obligation is incurred directly or as guarantor by or on behalf of  
8 another obligor that has also defaulted.

9 (B) Changes in the levels of interest rates, whether short or long  
10 term, or the differential in interest rates between various markets  
11 or products.

12 (C) Changes in the rate of exchange of currency.

13 (D) Changes in the value of financial or commodity indices, or  
14 price levels in general.

15 (E) Other events that the commissioner determines by order,  
16 regulation, or written consent are substantially similar to any of  
17 the foregoing.

18 (2) Notwithstanding paragraph (1), “financial guaranty  
19 insurance” shall not include any of the following:

20 (A) Insurance of any loss resulting from any event described in  
21 paragraph (1), if the loss is payable only upon the occurrence of  
22 any of the following, as specified in a surety bond, insurance  
23 policy, or indemnity contract:

24 (i) A fortuitous physical event.

25 (ii) A failure of or deficiency in the operation of equipment.

26 (iii) An inability to extract or recover a natural resource.

27 (B) Title insurance authorized by Section 104 and as permitted  
28 to be written by title insurers pursuant to Chapter 1 (commencing  
29 with Section 12340) of Part 6 of this division.

30 (C) Surety insurance as authorized by Section 105.

31 (D) Credit unemployment insurance, meaning insurance on a  
32 debtor in connection with a specific loan or other credit transaction,  
33 to provide payments to a creditor in the event of unemployment  
34 of the debtor for the installments or other periodic payments  
35 becoming due while a debtor is unemployed.

36 (E) Credit insurance authorized by Section 113.

37 (F) Guaranteed investment contracts and funding agreements  
38 issued by life insurance companies which provide that the life  
39 insurer itself will make specified payments in exchange for specific  
40 premiums or contributions.

1 (G) Mortgage insurance authorized by Section 117 and as  
2 permitted to be written by mortgage insurers pursuant to Chapter  
3 2 (commencing with Section 12420) of Part 6 of this division.

4 (H) Mortgage guaranty insurance authorized by Section 119  
5 and as permitted to be written by a mortgage guaranty insurer  
6 pursuant to Chapter 2A (commencing with Section 12640.01) of  
7 Part 6 of this division.

8 (I) Indemnity contracts or similar ~~guaranties~~ *guarantees*, to the  
9 extent that they are not otherwise limited or proscribed by this  
10 article, in which a life insurer does any of the following:

11 (i) ~~Guaranties~~ *Guarantees* its obligations or indebtedness or the  
12 obligations or indebtedness of a subsidiary (as defined in Section  
13 1215) other than a financial guaranty insurance corporation;  
14 provided that:

15 (I) To the extent that any such obligations or indebtedness are  
16 backed by specific assets, those assets shall at all times be owned  
17 by the life insurer or the subsidiary.

18 (II) In the case of the ~~guaranty~~ *guarantee* of the obligations or  
19 indebtedness of the subsidiary that are not backed by specific assets  
20 of the life insurer, the ~~guaranty~~ *guarantee* terminates once the  
21 subsidiary ceases to be a subsidiary.

22 (ii) ~~Guaranties~~ *Guarantees* obligations or indebtedness  
23 (including the obligation to substitute assets where appropriate)  
24 with respect to specific assets acquired by a life insurer in the  
25 course of normal investment activities and not for the purpose of  
26 resale with credit enhancement, or ~~guaranties~~ *guarantees*  
27 obligations or indebtedness acquired by its subsidiary, provided  
28 that the assets acquired pursuant to this clause have been either of  
29 the following:

30 (I) Acquired by a special purpose entity, whose sole purpose is  
31 to acquire specific assets of the life insurer or the subsidiary and  
32 issue securities or participation certificates backed by the assets.

33 (II) Sold to an independent third party.

34 (iii) ~~Guaranties~~ *Guarantees* obligations or indebtedness of an  
35 employee or agent of the life insurer.

36 (J) Any cramdown bond or mortgage repurchase bond, as those  
37 phrases are used by nationally recognized rating agencies in respect  
38 of mortgage-backed securities.

39 (K) Residual value insurance.

1 (L) Any other form of insurance covering risks that the  
2 commissioner determines by order, regulation, or written consent  
3 to be substantially similar to any of the foregoing.

4 (b) “Affiliate” means a person that, directly or indirectly, owns  
5 at least 10 but less than 50 percent of the financial guaranty  
6 insurance corporation or that is at least 10 percent but less than 50  
7 percent, directly or indirectly, owned by a financial guaranty  
8 insurance corporation.

9 (c) “Asset-backed securities” means either of the following:

10 (1) Securities or other financial obligations of an issuer provided  
11 that both of the following apply:

12 (A) The issuer is a special purpose corporation, trust, or other  
13 entity, or, provided that the securities or other financial obligations  
14 constitute an insurable risk, is a bank, trust company, or other  
15 financial institution, deposits in which are insured by the Bank  
16 Insurance Fund or the Savings Association Insurance Fund of the  
17 Federal Deposit Insurance Corporation or any successors thereto.

18 (B) The securities or other financial obligations are related to  
19 a pool of assets so that all of the following apply:

20 (i) The pool of assets has been conveyed, pledged, or otherwise  
21 transferred to or is otherwise owned or acquired by the issuer.

22 (ii) The pool of assets backs the securities or other financial  
23 obligations issued.

24 (iii) No asset in the pool, other than an asset directly payable  
25 by, ~~guaranteed~~ *guaranteed* by, or backed by the full faith and credit  
26 of the United States ~~government~~ *Government* or that otherwise  
27 qualifies as collateral under paragraph (1) or (2) of subdivision  
28 (e), has a value exceeding 20 percent of the aggregate value of the  
29 pool.

30 (2) A pool of credit default swaps or credit default swaps  
31 referencing a pool of obligations, provided that each of the  
32 following is true:

33 (A) The swap counterparty whose obligations are insured under  
34 the credit default swap is a special purpose corporation, special  
35 purpose trust, or other special purpose legal entity.

36 (B) No reference obligation in the pool, other than an obligation  
37 directly payable by, ~~guaranteed~~ *guaranteed* by, or backed by the  
38 full faith and credit of the United States ~~government~~ *Government*,  
39 or that otherwise qualifies as collateral under paragraph (2) of

subdivision (e), has a notional amount exceeding 10 percent of the pool's aggregate notional amount.

(C) The insurer has the benefit of a deductible or other first loss credit protection against claims under its insurance policy.

(d) "Average annual debt service" means the amount of insured unpaid principal and interest on an obligation multiplied by the number of the insured obligations (assuming that each obligation represents a \$1,000 par value), divided by the amount equal to the aggregate life of all of those obligations. This definition, expressed as a formula in regard to bonds, is as follows:

$$\text{Average Annual Debt Service} = \frac{\text{Total Debt Service} \times \text{Number of Bonds}}{\text{Bond Years}}$$

$$\text{Total Debt Service} = \frac{\text{Insured Unpaid Principal} + \text{Interest}}{\text{Number of Bonds} = \frac{\text{Total Insured Principal}}{\$1,000}}$$

$$\text{Bond Years} = \text{Number of Bonds} \times \text{Term in Years}$$

Term in Years = Term to maturity based on scheduled amortization or, in the absence of a scheduled amortization in the case of asset-backed securities or other obligations lacking a scheduled amortization, expected amortization, in each case determined as of the date of issuance of the insurance policy based upon the amortization assumptions employed in pricing the insured obligations or otherwise used by the insurer to determine aggregate net liability.

(e) "Collateral" means any of the following:

(1) Cash.

(2) The cashflow from specific obligations which are not callable and scheduled to be received based on expected prepayment speed on or prior to the date of scheduled debt service (including scheduled redemptions and prepayments) on the insured obligation, provided that any of the following is true, as applicable:

(A) The specific obligations are directly payable by, ~~guaranteed~~ *guaranteed* by or backed by the full faith and credit of the United States ~~government~~ *Government*.

(B) In the case of insured obligations denominated or payable in a foreign currency as permitted under paragraph (3) of

subdivision (b) of Section 12112, the specific obligations are directly payable by, ~~guaranteed~~ *guaranteed* by, or backed by the full faith and credit of the foreign government or the central bank thereof.

(C) The specific obligations are insured by the same insurer that insures the obligations being collateralized, and the cashflows from the specific obligations are sufficient to cover the insured scheduled payments on the obligations being collateralized.

(3) The market value of investment grade obligations, other than obligations evidencing an interest in the project or projects financed with the proceeds of the insured obligations.

(4) The face amount of each letter of credit that meets all of the following criteria:

(A) Is irrevocable.

(B) Provides for payment under the letter of credit in lieu of or as reimbursement to the insurer for payment required under a financial guaranty insurance policy.

(C) Is issued, presentable, and payable either:

(i) At an office of the letter of credit issuer in the United States.

(ii) At an office of the letter of credit issuer located in the jurisdiction in which the trustee or paying agent for the insured obligation is located.

(D) Contains a statement that either:

(i) Identifies the financial guaranty insurance corporation, its collateral agent, or any successor by operation of law, including any liquidator, rehabilitator, receiver or conservator, as the beneficiary.

(ii) Identifies the trustee or the paying agent for the insured obligation as the beneficiary.

(E) Contains a statement to the effect that the obligation of the letter of credit issuer under the letter of credit is an individual obligation of that issuer and is in no way contingent upon reimbursement with respect thereto.

(F) Contains an issue date and an expiration date.

(G) ~~Either~~ *Does either of the following*:

(i) Has a term at least as long as the shorter of the term of the insured obligation or the term of the financial guaranty insurance policy; ~~or~~.

(ii) Provides that the letter of credit shall not expire without 30 days prior written notice to the beneficiary and allows for drawing



1 under the letter of credit in the event that, prior to expiration, the  
2 letter of credit is not renewed or extended or a substitute letter of  
3 credit or alternate collateral meeting the requirements of  
4 subdivision (e) is not provided.

5 (H) If the letter of credit is governed by the 1983 revision of  
6 the Uniform Customs and Practice for Documentary Credits of  
7 the International Chamber of Commerce (Publication 400 or 500),  
8 or any successor revision approved by the commissioner, it shall  
9 contain a provision for an extension of time, of not less than 30  
10 days after resumption of business, to draw against the letter of  
11 credit in the event that one or more of the occurrences described  
12 in Article 19 of Publication 400 or 500 occurs.

13 (I) Is issued by a bank, trust company, or savings association  
14 that meets all of the following criteria:

15 (i) Is organized and existing under the laws of the United States  
16 or any state thereof or, in the case of a financial institution  
17 organized under the laws of a foreign country, has a branch or  
18 agency office licensed under the laws of the United States or any  
19 state thereof and is domiciled in a member country of the  
20 Organization of Economic Co-operation and Development having  
21 a sovereign rating in one of the top two generic lettered rating  
22 classifications by a securities rating agency acceptable to the  
23 commissioner.

24 (ii) Has (or is the principal operating subsidiary of a financial  
25 institution holding company that has) a long-term debt rating of  
26 at least investment grade.

27 (iii) Is not a parent, subsidiary or affiliate of the trustee or paying  
28 agent, if any, with respect to the insured obligation if that trustee  
29 or paying agent is the named beneficiary of the letter of credit.

30 (5) The amount of credit protection available to the insurer (or  
31 its nominee) under each credit default swap that satisfies each of  
32 the following:

33 (A) May not be amended without the consent of the insurer and  
34 may only be terminated in accordance with one of the following:

35 (i) At the option of the insurer.

36 (ii) At the option of the counterparty to the insurer (or its  
37 nominee), if the credit default swap provides for the payment of  
38 a termination amount equal to the replacement cost of the  
39 terminated credit default swap determined with reference to

1 standard documentation of the International Swap and Derivatives  
2 Association, Inc. or otherwise acceptable to the commissioner.

3 (iii) At the discretion of the commissioner acting as rehabilitator,  
4 liquidator, or receiver of the insurer upon payment by or on behalf  
5 of the insurer of any termination amount due from the insurer.

6 (B) Provides for payment under all instances in which payment  
7 under a financial guaranty insurance policy is required, except that  
8 payment under the credit default swap may be on a first loss, excess  
9 of loss, or other nonpro-rata basis and may apply on an aggregate  
10 basis to more than one policy.

11 (C) Is provided by one of the following:

12 (i) A counterparty whose obligations under the credit default  
13 swap are insured by a financial guaranty insurance corporation  
14 licensed under this article or guaranteed by a financial institution  
15 referred to in clauses (ii) and (iii) of this subparagraph.

16 (ii) A financial institution satisfying the requirements of clauses  
17 (i) to (iii), inclusive, of subparagraph (I) of paragraph (4), provided  
18 that obligations of the financial institution on parity with its  
19 obligations under the credit default swap are rated as investment  
20 grade, and further provided that, if the financial institution is not  
21 organized under, or acting through a branch or agency office  
22 licensed under, the laws of the United States or any state thereof,  
23 then the financial institution is required to collateralize the  
24 replacement cost of the credit default swap in the event that it fails  
25 to maintain the investment grade rating.

26 (iii) Any other financial institution that the commissioner  
27 determines to be substantially similar to any specified in clause  
28 (i) or (ii).

29 (iv) The requirements of this subparagraph shall not be construed  
30 as authority for an insurer domiciled in the United States to issue  
31 credit default swaps unless the insurer has explicit authority to  
32 issue credit default swaps.

33 Collateral shall be deposited with or held by the financial  
34 guaranty insurance corporation, held by a trustee or agent for the  
35 benefit of the financial guaranty insurance corporation in trust or  
36 to perfect a security interest, or held in trust pursuant to the bond  
37 indenture or other trust arrangement by a trustee or custodian for  
38 the benefit of holders of the insured obligations in the form of  
39 funds for payment of insured obligations, sinking funds, or other  
40 reserves which may be used for the payment of insured obligations,

1 collateral agent fees and trustee fees, or reimbursement of the  
2 financial guaranty insurance corporation on any obligation insured  
3 by the corporation. Any such trustee, custodian, or agent shall be  
4 a bank, savings association, depository institution, or other entity  
5 acceptable to the commissioner, the deposits of which are insured  
6 by the Bank Insurance Fund or the Savings Association Insurance  
7 Fund of the Federal Deposit Insurance Corporation (or any  
8 successors thereto), or in the case of banking organizations  
9 organized under the laws of a foreign country in addition satisfies  
10 the requirements of clauses (i) and (ii) of subparagraph (I) of  
11 paragraph (4) of subdivision (e) of Section 12100, and, in each  
12 case which has a net worth of at least twenty-five million dollars  
13 (\$25,000,000). Any such trustee or agent may also be an approved  
14 or qualified servicer or originator of the kind of assets which  
15 comprise the collateral which maintains in force at all times errors  
16 and omissions insurance applicable to the trust or agency activities,  
17 including without limitation, a servicer qualified under a federal  
18 or state insurance or guaranty program to service loans or mortgage  
19 loans. The commissioner may adopt regulations, bulletins, notices  
20 or orders to limit the amount of collateral provided by obligations,  
21 letters of credit, or credit default swaps, or to limit the amount of  
22 collateral provided by any single issuer, bank, or counterparty as  
23 provided for in this subdivision. The commissioner may also  
24 require additional reporting as deemed necessary.

25 (f) "Commercial real estate" means income-producing real  
26 property other than residential property consisting of less than five  
27 units.

28 (g) "Contingency reserve" means an additional liability reserve  
29 established to protect policyholders against the effects of adverse  
30 economic cycles or other unforeseen circumstances.

31 (h) "Credit default swap" means an agreement referencing credit  
32 derivative definitions published from time to time by the  
33 International Swap and Derivatives Association, Inc., or otherwise  
34 acceptable to the commissioner, pursuant to which a party agrees  
35 to compensate another party in the event of a payment default by,  
36 insolvency of, or other adverse credit event in respect of, an issuer  
37 of a specified security or other obligation. ~~Such an agreement shall~~  
38 ~~not constitute an insurance contract and the making of a credit~~  
39 ~~default swap shall not constitute the transaction of insurance.~~  
40 *obligation; provided that the agreement does not constitute an*

1 *insurance contract and the making of the credit default swap does*  
2 *not constitute the transaction of insurance.*

3 (i) “Excess spread” means, with respect to any insured issue of  
4 asset-backed securities, the excess of (A) the scheduled cashflow  
5 on the underlying assets that is reasonably projected to be available,  
6 over the term of the insured securities after payment of the expenses  
7 associated with the insured issue, to make debt service payments  
8 on the insured securities over (B) the scheduled debt service  
9 requirements on the insured securities, provided that this excess  
10 is held in the same manner as collateral is required to be held under  
11 subdivision (e).

12 (j) “Financial guaranty insurance corporation” means an insurer  
13 transacting financial guaranty insurance.

14 (k) “Governmental unit” means a state, territory, or possession  
15 of the United States of America, the District of Columbia, the  
16 country of Canada, a province of Canada, the United Kingdom, a  
17 public authority of the United Kingdom, a member country of the  
18 ~~Organisation~~ *Organization* for Economic Co-operation and  
19 Development having a sovereign rating in one of the top two  
20 generic lettered rating classifications by a securities rating agency  
21 acceptable to the commissioner, a municipality, or a political  
22 subdivision of any of the foregoing, or any public agency or  
23 instrumentality thereof.

24 (l) ~~“Guaranties”~~ *“Guarantees”* of consumer debt obligations”  
25 means insurance policies indemnifying a purchaser or lender  
26 against loss or damage resulting from defaults on a pool of debts  
27 owed for extensions of credit (including in respect of installment  
28 purchase agreements and leases) to individuals provided in the  
29 normal course of the purchaser’s or lender’s business, provided  
30 that the pool meets the requirements of paragraph (2) of subdivision  
31 (c) and that the pool has been determined to be investment grade.  
32 Policies providing that coverage shall contain a provision that all  
33 liability terminates upon sale or transfer of the underlying  
34 obligation to any transferee that is not an insured of the financial  
35 guaranty insurance corporation under a similar policy.

36 (m) “Industrial development bond” means any security, or other  
37 instrument under which a payment obligation is created, issued by  
38 or on behalf of a governmental unit to finance a project serving a  
39 private industrial, commercial, or manufacturing purpose and not  
40 ~~guaranteed~~ *guaranteed* by a governmental unit.

1 (n) “Insurable risk” means that the obligation on an uninsured  
2 basis has been determined to be not less than investment grade.  
3 With respect to asset-backed securities as defined in subdivision  
4 (c), the determination shall be, based solely on the pool of assets  
5 backing the insured obligation or securing the financial guaranty  
6 insurance corporation, without consideration of the  
7 creditworthiness of the issuer.

8 (o) “Investment grade” means that the obligation or parity  
9 obligation of the same issuer is rated in one of the top four generic  
10 lettered rating classifications by a securities rating agency  
11 acceptable to the commissioner, that the obligation or parity  
12 obligation of the same issuer, without regard to financial guaranty  
13 insurance, has been identified in writing by that rating agency as  
14 an insurable risk deemed to be of investment grade quality, or that  
15 the obligation or parity obligation of the same issuer has been  
16 determined to be investment grade (as indicated by a category 1  
17 or 2 rating) by the Securities Valuation Office of the National  
18 Association of Insurance Commissioners.

19 (p) “Municipal bonds” means municipal obligation bonds and  
20 special revenue bonds.

21 (q) (1) “Municipal obligation bond” means any security, or  
22 other instrument, including a lease payable or ~~guaranteed~~  
23 *guaranteed* by the United States or another national government  
24 that qualifies as a governmental unit, or any agency, department,  
25 or instrumentality thereof, or by a state or an equivalent subdivision  
26 of another national government that qualifies as a governmental  
27 unit, but not a lease of any other governmental unit, under which  
28 a payment obligation is created, issued by or on behalf of a  
29 governmental unit or issued by a special purpose corporation,  
30 special purpose trust, or other special purpose legal entity to finance  
31 a project or undertaking serving a substantial public purpose, and  
32 which is one or more of the following:

33 (A) Payable from tax revenues, but not tax allocations, within  
34 the jurisdiction of the governmental unit.

35 (B) Payable or ~~guaranteed~~ *guaranteed* by the United States of  
36 America or another national government that qualifies as a  
37 governmental unit, or any agency, department, or instrumentality  
38 thereof, or by a housing agency of a state or an equivalent political  
39 subdivision of another national government that qualifies as a  
40 governmental unit.

1 (C) Payable from rates or charges (but not tolls) levied or  
2 collected in respect of a nonnuclear utility project, public  
3 transportation facility (other than an airport facility) or public  
4 higher education facility.

5 (D) With respect to lease obligations, payable from past, present,  
6 or future appropriations.

7 (2) Notwithstanding paragraph (1), obligations of a special  
8 purpose corporation, special purpose trust, or other special purpose  
9 legal entity shall not be considered municipal obligation bonds  
10 unless the obligations are investment grade at the time of issuance,  
11 the obligations are payable from sources enumerated in  
12 subparagraphs (A) to (D), inclusive, and the project being financed  
13 or the tolls, tariffs, usage fees, or other similar rates or charges for  
14 its use are subject to regulation or oversight by a governmental  
15 entity.

16 (r) “Parent” means a person that, directly or indirectly, owns at  
17 least 50 percent of a financial guaranty insurance corporation.

18 (s) “Reinsurance” means cessions qualifying for credit under  
19 Section 12121.

20 (t) “Security” or “secured” means any of the following:

21 (1) A deposit at least equal to the full amount of the outstanding  
22 principal of the insured obligation.

23 (2) Collateral, as defined by subdivision (e), at least equal to  
24 the full amount of the outstanding principal of the insured  
25 obligation or that has a market value or scheduled cashflow which  
26 is equal to or greater than the scheduled debt service on the insured  
27 obligation.

28 (3) Property, provided the financial guaranty insurance  
29 corporation or the trustee has possession of evidence of the right,  
30 title, or authority to claim or foreclose thereon or otherwise dispose  
31 of the property for value, the scheduled cashflow from which, or  
32 market value thereof, is at least equal to the scheduled debt service  
33 on the insured obligation.

34 (u) “Special revenue bond” means any security or other  
35 instrument under which a payment obligation is created, issued by  
36 or on behalf of, or payable or ~~guaranteed~~ *guaranteed* by, a  
37 governmental unit to finance a project or undertaking serving a  
38 substantial public purpose and not payable from the sources  
39 enumerated in subdivision (q) or securities which are substantially  
40 similar to the foregoing issued by any of the following:

1 (1) A not-for-profit corporation.

2 (2) A special purpose corporation, special purpose trust or other  
3 special purpose legal entity, provided that the obligations are  
4 investment grade at the time of issuance, the obligations are not  
5 payable from the sources enumerated in subparagraphs (A) to (D),  
6 inclusive, of paragraph (1) of subdivision (q), and the project being  
7 financed or the tolls, tariffs, usage fees, or other similar rates or  
8 charges for its use are subject to regulation or oversight by a  
9 governmental entity.

10 (v) “Subsidiary” means a person that, directly or indirectly, is  
11 at least 50 percent owned by a financial guaranty insurance  
12 ~~corporation~~ corporation.

13 (w) “Total net liability” of a financial guaranty insurance  
14 corporation means the aggregate amount of insured unpaid  
15 principal, interest, and other monetary payments, if any, of  
16 ~~guaranteed~~ *guaranteed* obligations insured or assumed, less  
17 reinsurance and less collateral.

18 (x) “Utility first mortgage obligation” means an obligation of  
19 an issuer secured by a first priority mortgage on property owned  
20 or leased by an investor-owned or cooperative-owned utility  
21 company and located in the United States, Canada, or a member  
22 country of the Organization for Economic Co-operation and  
23 Development having a sovereign rating in one of the top two  
24 generic lettered rating classifications by a securities rating agency  
25 acceptable to the commissioner, provided that the utility or utility  
26 property or the usage fees or other similar utility rates or charges  
27 are subject to regulation or oversight by a governmental entity.

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